

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200825010**

Release Date: 6/20/2008

Person To Contact:

, ID No.

Index Number: 851.00-00, 851.02-00, 562.03-00

Telephone Number:

Refer Reply To:

CC:FIP:2

PLR-132125-07

Date:

March 13, 2008

Legend

Trust =

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Fund 5 =

Fund 6 =

Fund 7 =

Fund 8 =

Former Advisor =

Principals =

Distribution Plan =

Orders =

State =

a =

b =

Dear :

This responds to your request dated July 10, 2007, and supplemental correspondence dated October 2, 2007, and March 3, 2008, submitted on behalf of Funds 1 through 8 (each a "Fund" and, collectively, "Funds") by your authorized representative. You request that the Internal Revenue Service rule as follows: First, that any income recognized by the Funds as a result of the Distribution Plan will constitute qualifying income for purposes of section 851(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code") and second, that payments made to shareholders as provided in the Distribution Plan will not result in preferential dividends under section 562(c).

FACTS

Trust is a State statutory trust and is registered as an open-end series management investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., as amended (the "1940 Act"). Funds are segregated portfolios of Trust. Trust has elected to be treated as a regulated investment company (RIC) under section 851 of the Code.

The SEC has issued an Order that alleges that Former Advisor made various material omissions and misrepresentations regarding market timing involving the Funds and that the Former Advisor and the Principals committed certain other wrongful acts relating to market timing trades in the shares. The SEC has also issued related orders directed at the Principals of the Former Advisor. Collectively, the Order against the Former Advisor and the Order against the Former Principals of the Former Advisor are hereinafter referred to as Orders. The Orders define market timing to include (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. The SEC, based on the improper conduct described in the Orders and the alleged resulting damage to mutual fund shareholders, sought profit disgorgement and civil penalties. Former Advisor and Principals have agreed to pay \$a to settle the SEC's claims.

The Orders provide that a "Fair Fund" be established pursuant to section 308(a) of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, for disgorgement and penalty components of the settlement, thus permitting both components to be paid to injured shareholders. The Fair Fund is intended to be a "qualified settlement fund" as described in section 468B of the Code and the Income Tax Regulations (the "Regulations") thereunder.

The Orders require the Former Advisor to develop a distribution plan for the distribution from the Fair Fund of the disgorgement and penalties (together with any interest earned pending distribution) (the "Distribution Plan") using a methodology acceptable to the SEC staff and the independent trustees of the Funds. The Orders authorize the Distribution Plan to provide for shareholders to receive their proportionate share of losses suffered by Funds due to market timing, and a proportionate share of advisory fees paid by the Funds that suffered losses during the period of market timing. Funds represent that losses realized from the sale of portfolio assets served either (1) to reduce Fund net capital gain in the year of sale of assets; (2) to create or to contribute to the creation of a capital loss carryover that reduced Fund net capital gain in years subsequent to the sale of assets; or (3) to create or to contribute to the creation of a capital loss carryover that has not yet expired.

The Distribution Plan provides for disbursement of payments from the Fair Fund directly to those shareholders (other than shareholders known to have participated in market timing) holding shares in the Funds during any portion of the time period specified by the Orders. The amount available for distribution (the "Primary Distribution") includes both the amount transferred by the Former Advisor and the Principals into the Fair Fund and the net interest income earned by the Fair Fund to the date of distribution. Under the Distribution Plan, the amount of the Primary Distribution to be received by each shareholder is determined first, by allocating the amounts held in the Fair Fund among the Funds based upon quarterly percentages of the estimated short-term profits earned by market timers with respect to each Fund; second, by allocating the quarterly amounts attributed to each Fund to each day in the quarter; and

third, by allocating the daily amounts among the shareholders in proportion to their shareholdings in each Fund on that particular day. Only those shareholders, however, whose total share of the Primary Distribution for losses in all Funds is at least \$b are entitled to receive distributions under the Distribution Plan. Amounts attributed to shareholders whose share of the recovery is less than \$b are reallocated to “gross-up” amounts allocable to shareholders whose share of the recovery is less than \$b. As a result, certain shareholders whose share is less than \$b will receive \$b, while certain shareholders with even smaller shares will receive nothing.

The Distribution Plan also provides that any amounts that are not distributed to shareholders will be distributed to the Funds (the “Residual Distribution”) using the same method of allocation as in the Primary Distribution, in accordance with the quarterly percentages of the estimated short-term profits earned by market timers with respect to each Fund. The Residual Distribution will include (i) funds intended for distribution to shareholders for which settlement checks were never cashed, (ii) all net interest (after taxes) earned on amounts held in the Fair Fund after the checks or payment orders have been drawn pending clearance, and (iii) amounts that would have otherwise been paid under the Distribution Plan to shareholders who market-timed the Funds and waived their rights to such distributions pursuant to separate settlements with the SEC. The Residual Distribution may also include amounts received from future settlements with other defendants in market timing litigation involving the Funds.

LAW AND ANALYSIS

Ruling Request (1): Any income recognized by the Funds as a result of the Distribution Plan will constitute qualifying income for purposes of section 851(b)(2).

Section 851(a) of the Code defines a RIC, in part, as a domestic corporation registered under the 1940 Act as a management company.

Section 851(b) of the Code limits the definition of a RIC to a corporation meeting certain election, gross income, and diversification requirements.

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it derives at least 90 percent of its gross income from certain enumerated sources (qualifying income). In 1986 Congress amended section 851(b)(2) to include as qualifying income other income derived with respect to a RIC’s business of investing in stock, securities, or currencies (the “other income” clause). Section 851(b)(2) now defines qualifying income, in relevant part, as—

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign

currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies

In Rev. Rul. 92-56, 1992-2 C.B. 153, the Service concluded that a reimbursement of advisory fees paid in a prior year and received by a RIC from its investment advisor in the normal course of business and not as a result of a transaction entered into to artificially inflate the RIC's qualifying gross income was qualifying income under the other income clause of section 851(b)(2) of the Code.

Recoveries of excessive investment advisory fees are similar to the reimbursed advisory fees described in Rev. Rul. 92-56. These fees are incurred in the normal course of Funds' business of investing in stock, securities and currencies. Recovery of overcharges of these fees through litigation or settlement relates directly to this normal course of business. The recovery of compensation for losses realized on the sale of portfolio assets in response to frequent requests for redemption by market timers bears a similar relation to the normal course of Funds' business. Penalty amounts imposed in response to the overcharge of investment advisory fees and in compensation for losses realized on the sale of portfolio assets are directly attributable to these recoveries and thus to the conduct of Funds' normal course of business. Accordingly, we rule that income recognized by Funds from the Distribution Plan attributable to payments in compensation for the overcharge of investment advisory fees and for losses realized on the sale of portfolio assets and penalty amounts is qualifying income under section 851(b)(2) of the Code. Interest amounts received by Funds pursuant to the Distribution Plan also constitute qualifying income under section 851(b)(2) because interest is a type of qualifying income expressly enumerated in that section.

Ruling Request (2): Payments made to shareholders as provided in the Distribution Plan will not result in preferential dividends under section 562(c).

Section 562(c) of the Code provides that the amount of any distribution by a RIC to its shareholders shall not be considered a dividend for purposes of computing the dividends paid deduction, unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

Rev. Proc. 99-40, 1999-2 C.B. 565, describes conditions under which distributions made to shareholders of a RIC may vary and nevertheless be deductible as dividends under section 562 of the Code. The Distribution Plan provides for the allocation of the distributions of recovered investment advisory

fees, compensation for losses realized on the sale of portfolio assets, interest, and penalty amounts among the classes of shares of each Fund. Funds represent that, in accordance with section 4.03 of Rev. Proc. 99-40, the benefit of the reimbursement of investment advisory fees will be allocated to all its shares in proportion to the net asset value represented by each share without regard to any groupings (classes) of shares permitted under Rule 18f-3, 17 C.F.R. 270.18f-3 of the Investment Company Act of 1940 (the "1940 Act"). Funds also represent that the benefit of the reimbursement for realized capital losses and lost investment income will be allocated to each Fund's shares in proportion to the net asset value represented by each share and without regard to any groupings (classes) of shares permitted under Rule 18f-3 of the 1940 Act.

In accordance with Rev. Proc. 99-40, we rule that the allocation of the reimbursements of investment advisory fees recovered by the Funds pursuant to the Distribution Plan do not result in preferential dividends under section 562(c) of the Code. We rule further that, although not covered in Rev. Proc. 99-40, related and corresponding allocations of amounts recovered pursuant to the Distribution Plan as compensation for losses realized on the sale of portfolio assets, as interest, and as penalties among the classes of shares of each Fund in a manner consistent with Rev. Proc. 99-40 do not give rise to preferential dividends.

No opinion is expressed or implied concerning the federal income tax consequences of the transaction described in this letter, except as expressly provided. No opinion is expressed as to whether or to what extent the Funds will recognize income from the Primary and Residual Distributions. No opinion is expressed regarding the character of the payments to the Funds or their shareholders from the Fair Fund.

This ruling is directed only to the Funds who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter should be attached to the federal income tax return of a Fund for each taxable year in which it receives recoveries of investment advisory fees, amounts in the nature of interest, and penalty amounts pursuant to the Order and in which it makes distributions to its shareholders pursuant to the Distribution Plan as described in this letter. Alternatively, a Fund filing its income tax return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Susan Thompson Baker
Susan Thompson Baker
Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Financial Institutions & Products)